Supreme Court, U.S.
FILED

01 - 158 JUL 23 2000

OFFICE OF THE CLERK

No.

IN THE
SUPREME COURT OF THE UNITED STATES

In re: ARNOLD I. MEYER, Debtor.

HARRY SHAIA, JR., TRUSTEE,

Petitioner,

v.

ARNOLD I. AND NAOMI A. MEYER,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

---

PETITION FOR WRIT OF CERTIORARI

James J. Burns, *Counsel of Record*
Patrick R. Hanes
WILLIAMS, MULLEN, CLARK & DOBBINS, P.C.
P.O. Box 1320
1021 E. Cary Street
Richmond, Virginia 23218-1320
(804) 643-1991

99 pp

I. QUESTIONS PRESENTED

Whether a Bankruptcy Court can set aside an indirect transfer by a debtor to the debtor and his non-bankrupt spouse, which occurs by means of the debtor's pre-payment of two home mortgages, secured by real estate owned by the debtor and his non-bankrupt spouse as tenants by the entireties?

Whether the equity powers of the Bankruptcy Court permit the Bankruptcy Court to find that a debtor's pre-bankruptcy lump sum pre-payment of two home mortgages encumbering a residence owned by the debtor and his non-bankrupt spouse in a tenancy by the entireties was in substance a voluntary transfer to the debtor and his spouse, and avoid such transfer under 11 U.S.C. § 544(b)(1) and Virginia Code § 55-81?

Whether White v. Pacific Mutual, 150 Va. 849, 143 S.E. 340 (1928) and Stigler v. Stigler, 77 Va. 163 (1883) permit the Trustee in bankruptcy to avoid as a voluntary conveyance, payments made by a debtor to pre-pay two home mortgages secured by real estate owned by the debtor and his non-bankrupt spouse, as tenants by the entireties under 11 U.S.C. § 544(b)(1) and Virginia Code § 55-81?

II. PARTIES

All of the parties to the proceeding are identified in the caption of the case.

III. TABLE OF CONTENTS

I. Questions Presented i

II. Parties ii

III. Table of Contents iii

IV. Table of Authorities iv

V. Lower Court Case Citations 1

VI. Statement of Jurisdiction 1

VII. Statutory Provisions 2

A. 11 U.S.C. § 101(54) 2
B. 11 U.S.C. § 105(a) 2
C. 11 U.S.C. § 522(b)(2)(B) 2
D. 11 U.S.C. § 544(b)(1) 2
E. Va. Code § 55-80 3
F. Va. Code § 55-81 3

VIII. Statement of the Case 4

IX. Argument 11

A. The Court Should Resolve the Conflict Between the Fourth Circuit's Restrictive Interpretation of "Transfer" Preventing a Bankruptcy Court from Setting

Aside an Indirect Transfer and the Court's prior Decisions Approving the Avoidance of Indirect Transfers.....12

B. The Court Should Resolve the Conflict Between the Fourth Circuit's Restrictive Interpretation of "Transfer" and the Court's Prior Decisions Outlining the Scope of the Bankruptcy Court's Equitable Powers and Provide Guidance to Lower Federal Courts in the Proper Exercise of Those Powers. 18

C. The Court Should Resolve the Conflict Between the Fourth Circuit's Restrictive and Formalistic Interpretation of "Transfer" and the Virginia Supreme Court's Decision in Pactific Mutual and Stigler, Where Substance Prevailed over the Form of the Transaction Subject to Avoidance.....23

CONCLUSION 28

IV. TABLE OF AUTHORITIES

CASES

Aulick v. Largent, 295 F.2d 41, 52 (4th Cir. 1961) 13,18

Barnhill v. Johnson, 503 U.S. 393 (1992) 27

BFP v. Resolution Trust Corporation, 511 U.S. 531 (1994) 27

Brockington v. Scott, 381 F.2d 792, 794 (4th Cir. 1967) 19

Citizens Bank of Maryland v. Strumpf, 516 U.S. 16 (1995) 27

Cramer v. Senger & Turner, 107 Va. 400, 59 S.E. 375 (1907) ..... passim

Dean v. Davis, 242 U.S. 438, 442 (1917) 12,18,20

Fidelity Financial Services, Inc. v. Fink, 522 U.S. 211 (1998) 27

In re A.H. Robins Company, Inc., 880 F.2d 694, 702 (4th Cir. 1989) 19

In re C-L Cartage Co., Inc., 899 F.2d 1490, 1494-95 (6th Cir. 1990) 14

In re Covino, 187 B.R. 773 (Bankr. S.D. Fla. 1995) 17

In re H & S Transportation Company, Inc., 939 F.2d 355, 358-360 (6th Cir. 1991) 14

In re Meredith Hoffman Partners, 12 F.3d 1549, 1557-58 (10th Cir. 1994) 14

In re Meyer, U.S. Dist. Ct. Civ. Act. No. 3:97cv352 at 12-13 (Mar. 12, 1998) 4

In re Porter, 37 B.R. 56 (Bankr. E.D. Va. 1984) ..... passim

In re Suffola, 2 F.3d 977, 981-82 (9th Cir. 1993) 14

In re T.B. Westex Foods, Inc., 950 F.2d 1187, 1193-95 (5th Cir. 1992) 14

In re Theisen, 45 B.R. 122 (Bankr. D. Minn. 1984) . 17

In re White, 28 B.R. 240, 243 (Bankr. E.D. Va. 1983) 8, 10

Katchen v. Landy, 382 U.S. 323, 327 (1966) 19

Levit v. Ingersoll Rand Fin. Corp., 874 F. 2d 1186 (7th Cir. 1989) 13

National Bank of Newport v. National Herkimer County Bank, 225 U.S. 178, 184 (1912) 12,18

NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527 (1984) 19

Pepper v. Litton, 308 U.S. 295, 304 (1930) 19, 20

Raleigh v. Illinois Dept. of Revenue, 530 U.S. 15 (2000) 27

Stigler v. Stigler, 77 Va. 163 (1883) ..... passim

White v. Pacific Mut. Life Ins. Co., 150 Va. 849, 143 S.E. 340 (1928) ..... passim

STATUTES

11 U.S.C. § 101(54) ..... iii, 2
11 U.S.C. § 105(a) ..... iii, 2
11 U.S.C. § 522(b)(2)(B)(2000) ..... passim
11 U.S.C. § 544(b)(1) ..... passim
11 U.S.C. § 550(c)(2000) 15
Va. Code § 55-81 ..... passim
Virginia Code § 55-80 3
Virginia Code § 55-81 ..... i, 3, 2, 3
Virginia Code §§ 55-80 5
Virginia Code Section 55-81 ..... 5, 6

V. LOWER COURT CASE CITATIONS

The opinion of the United States Court of Appeals for the Fourth Circuit appears at Appendix ("App.") 1 and is reported at 244 F.3d 352 (4th Cir. March 28, 2001). The order of the United States Court of Appeals for the Fourth Circuit on petition for rehearing and rehearing *en banc* appears at App. 13 and is unpublished (4th Cir. April 24, 2001).

The memorandum opinion and order of the United States District Court for the Eastern District of Virginia appears at App. 15, and is unpublished.

The order and memorandum opinion of the United States Bankruptcy Court for the Eastern District of Virginia appears at App. 38, and is reported at 206 B.R. 410 (Bankr. E.D. Va. 1997).

VI. STATEMENT OF JURISDICTION

Petitioner Harry Shaia, Jr. seeks review of an opinion issued by the United States Court of Appeals for the Fourth Circuit on March 28, 2001. Petitioner Harry Shaia, Jr.'s petition for rehearing and rehearing *en banc* was denied by order of the United States Court of Appeals for the Fourth Circuit filed April 24, 2001. This Court has jurisdiction to issue a writ of certiorari pursuant to 28 U.S.C. § 1254(1).

VII. STATUTORY PROVISIONS

A. 11 U.S.C. § 101(54).

"[T]ransfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption.

B. 11 U.S.C. § 105(a).

The court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

C. 11 U.S.C. § 522(b)(2)(B), reprinted at App. 61.

D. 11 U.S.C. § 544(b)(1).

Except as provided in paragraph (2), the trustee may avoid any transfer of an interest of the debtor in property or any

obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

E. Virginia Code § 55-80.

Every gift, conveyance, assignment or transfer of, or charge upon, any estate, real or personal, every suit commenced or decree, judgment or execution suffered or obtained and every bond or other writing given with intent to delay, hinder or defraud creditors, purchasers or other persons of or from what they are or may be lawfully entitled to shall, as to such creditors, purchasers or other persons, their representatives or assigns, be void. This section shall not affect the title of a purchaser for valuable consideration, unless it appear that he had notice of the fraudulent intent of his immediate grantor or of the fraud rendering void the title of such grantor.

F. Virginia Code § 55-81.

Every gift, conveyance, assignment, transfer or charge which is not upon consideration deemed valuable in law, or which is upon consideration of marriage, by an insolvent transferor, or by a transferor who is thereby rendered insolvent, shall be void as to creditors

whose debts shall have been contracted at the time it was made, but shall not, on that account merely, be void as to creditors whose debts shall have been contracted or as to purchasers who shall have purchased after it was made. Even though it is decreed to be void as to a prior creditor, because voluntary or upon consideration of marriage, it shall not, for that cause, be decreed to be void as to subsequent creditors or purchasers.

VIII. STATEMENT OF THE CASE

The Mortgage Pre-Payment

In February 1994, Arnold I. Meyer ("Mr. Meyer") owned real estate in Richmond, Virginia, with his wife Naomi A. Meyer ("Mrs. Meyer") (collectively, "Mr. & Mrs. Meyer") as tenants by the entireties (the "Meyer Home"). App. 4. The Meyer Home was encumbered by two mortgages, jointly owed by Mr. & Mrs. Meyer, which had a combined balance of $168,211.65 (the "Mortgages"). App. 4. At the same time, in addition to the Mortgages, Mr. Meyer owed individual unsecured liabilities of $201,922. App. 41.

In February 1994, Mr. Meyer received a lump sum cash bequest from the estate of his father in the amount of $169,223.71 (the "Bequest"). App.4. The Bequest was Mr. Meyer's individual asset. App. 3. Mr. Meyer deposited the Bequest into a "joint checking account that he shared" with Mrs. Meyer. App. 4. Mr. Meyer the delivered two checks drawn on the joint checking account to pre-pay the Mortgages (the "Pre-Payment"). App. 4. Accordingly, the Mortgages were

released as encumbrances against the Meyer Home. App. 4. As a result, the entire value of the Meyer Home ($175,000 at the time the Mortgages were released) became shielded under Virginia law from the reach of Mr. Meyer's individual creditors in the form of exempt home equity in the Meyer Home, because the Meyer Home was owned as tenants by the entireties. App. 5.

Mr. Meyer's Chapter 7 Bankruptcy Case

Mr. Meyer filed an individual Chapter 7 bankruptcy fifteen months after the Pre-Payment, and claimed exempt his entire interest in the Meyer Home pursuant to 11 U.S.C. § 522(b)(2)(B). App. 5.

The Trustee filed an objection to Mr. Meyer's claimed exemption of his interest in the Meyer Home and an adversary proceeding against Mr. & Mrs. Meyer in which the Trustee sought to recover the Pre-Payment as an avoidable voluntary transfer of Mr. Meyer's asset (the Bequest) to Mr. & Mrs. Meyer without adequate consideration received by Mr. Meyer's individual "estate." App. 5. The Trustee also asserted that the Pre-Payment was a fraudulent conveyance.[1] App. 5. The Trustee relied on the federal "strong arm" provisions of 11 U.S.C. § 544(b)(1), which allowed the Trustee to proceed under Virginia's voluntary and fraudulent conveyance statutes, contained in Virginia Code §§ 55-80 and 55-81. App. 2.

---

[1] Since the Bankruptcy Court held that the Pre-Payment was a voluntary conveyance, it did not address whether it was also a fraudulent conveyance, but expressed doubt that the Trustee had proven intent to defraud. App. 52, n. 7.

The Bankruptcy Court's Ruling

Following a one-day trial on November 14, 1996, the Bankruptcy Court ruled that the Pre-Payment was a voluntary conveyance avoidable under 11 U.S.C. § 544(b)(1), and the Virginia voluntary conveyance statute, Virginia Code § 55-81. App. 5-6.

Among other things, the Bankruptcy Court held that (a) the Pre-Payment was a transfer of the Bequest from Mr. Meyer's individual estate into joint equity in the Meyer Home, an asset which was claimed exempt from Mr. Meyer's bankruptcy case, (b) the transfer was made for consideration not deemed valuable in law, (c) the transfer rendered Mr. Meyer insolvent, (d) creditors existed at the time of the transfer who were eligible to avoid the transfer under applicable law, and that (e) it was appropriate to enter a joint and several judgment against Mr. & Mrs. Meyer for the amount of the Bequest, plus pre- and post-judgment interest until paid. App. 43-52. In addition, the Bankruptcy Court authorized the Trustee's sale of the Meyer Home, and imposed an equitable lien on it, pending the sale of the property. App. 52-57.

Explaining its holding that the Pre-Payment was a "transfer," the Bankruptcy Court reviewed federal and state cases applying Virginia's voluntary conveyance statute, including Cramer v. Senger & Tumer, 107 Va. 400, 59 S.E. 375 (1907), and In re Porter, 37 B.R. 56 (Bankr. E.D. Va. 1984). App. 43-47. Thereafter, the Bankruptcy Court found that the Pre-Payment, as a matter of substance, was indistinguishable from the direct and indirect transactions avoided as voluntary conveyances in

those cases. App. 46-47. Acting as a court of equity, and "[k]eeping in mind the equitable principle of 'substance over form,'" the Bankruptcy Court found that:

> by paying each mortgage note, [Mr. Meyer] transformed the cash bequest owned solely by him into equity in real property held by and his wife and himself as tenants by the entirety. The substance of the transaction is [that] property passed from one legal entity (the debtor) to another (the debtor and his wife as tenants by the entirety).

App. 47.

The Bankruptcy Court held further that there was no consideration for the transfer of the Bequest into equity in the Meyer Home and that "[Mr. Meyer] simply made a gift to the tenancy in the form of the satisfied mortgage notes." App. 47-48. The Trustee did not challenge, and the Bankruptcy Court did not disturb, the payments made to the mortgage companies; it was uncontested that the mortgage companies had given adequate consideration for the payments to them by releasing the mortgage notes. App. 47. However, the Bankruptcy Court held that a "second," or indirect transfer of unencumbered home equity to Mr. & Mrs. Meyer as tenants by the entirety was not supported by consideration deemed adequate in law and found this indirect transfer to be a voluntary conveyance. App. 47-48. This was based on the Bankruptcy Court's finding that "the tenancy by the entirety incurred no tangible or intangible legal detriment in exchange for the debtor's payment on its behalf." App. 47.

The District Court's Ruling

Mr. and Mrs. Meyer appealed the decision of the Bankruptcy Court to the District Court. App. 15.

The District Court affirmed each component of the Bankruptcy Court's decision, including the Bankruptcy Court's analysis of the indirect transfer under applicable precedent, noting that:

> Mr. Meyer impermissibly altered the ownership rights in the cash bequest which he received from his father's estate when he used it to pre-pay mortgages which he and his wife owed jointly. In so doing, Mr. Meyer attempted to transfer the cash bequest – his individual, non-exempt asset – from himself to himself and his wife as tenants by the entireties. The transfer of the cash bequest, therefore resulted in a corresponding increase in the equity in the exempt, real property.
>
> Considering the rather fundamental teaching of Cramer and the decisions in Porter and [In re White, 28 B.R. 240, 243 (Bankr. E.D. Va. 1983), relied upon by the court in Porter], it cannot be said that the Bankruptcy Court erred in finding that a transfer occurred and that the transaction should be voided to prevent the creditors from being prejudiced by Mr. Meyer's effort to convert the non-exempt cash bequest into an exempt asset.

App. 24-25.

The District Court also rejected Mr. Meyer's argument that the Pre-Payment was supported by adequate consideration:

> It is clear that Mr. and Mrs. Meyer, as tenants by the entirety, enjoyed the benefit of increased equity in the real property as a result of the mortgage payments. However, Mr. Meyer failed to demonstrate what, if any, detriment he and his wife, as tenants by the entirety, incurred as a result of these payments. The most obvious reason is that there was no detriment. . . . Mr. Meyer's cash payments, therefore, must be considered to be gifts to himself and his wife as tenants by the entirety. The Bankruptcy Court was correct in finding that there was no consideration.

App. 25.

The Fourth Circuit's Ruling

Mr. and Mrs. Meyer appealed the decision of the District Court to the United States Court of Appeals for the Fourth Circuit. App. 2.

The Fourth Circuit reversed the decision of the District Court by adopting a narrower view of the transfers involved in the Pre-Payment transaction. App. 6-12. In evaluating whether the challenged transfer was one which was supported by

consideration deemed adequate in law, the Fourth Circuit held that the Pre-Payment was "***a single transaction*** that was supported by consideration deemed adequate at law." App. 6 (emphasis supplied). The Fourth Circuit then evaluated the district court's reliance on Cramer, supra, White, supra, and Porter, supra, as supporting the application of the Voluntary Conveyance Statute to the second, or indirect, transfer, and rejected those cases as distinguishable and unpersuasive. App. 9-11.

The Fourth Circuit summarized its holding as follows:

> **The transfer in this case, which is sought to be avoided, is the payment of Meyer to the mortgage holders.** Because we hold that transfer was for "consideration deemed valuable in law" under Va. Code § 55-81, we proceed no further with our reasoning in this case. Section 55-81 does not apply, and thus we reject what may be called a second transfer theory, that the payment of the mortgages was itself a second transfer because the land was held by the entireties.

App. 10-11 (emphasis supplied).

IX. ARGUMENT

This case presents the Court with the unusual opportunity to examine and clarify both the scope of the Bankruptcy Court's analysis of an indirect transfer challenged as a voluntary conveyance and the

Bankruptcy Court's use of its equitable powers to conduct that inquiry. Such questions are critical to the Bankruptcy Court's role in resolving debtor-creditor issues at the heart of bankruptcy jurisprudence.

The Bankruptcy Court below, employing familiar equitable principles, concluded that the challenged indirect transfer was, in form, a lump-sum pre-payment of two home mortgages, but in substance, was a voluntary conveyance to the debtor and his non-bankrupt spouse that lacked consideration. Accordingly, the Bankruptcy Court held that the indirect transfer should be avoided and, among other things, entered joint and several judgment against Mr. & Mrs. Meyer. That decision was affirmed by the District Court, but reversed by the Fourth Circuit, which summarily and erroneously concluded, contrary to applicable precedent from this Court and the State of Virginia, that the Pre-Payment effected only one transfer, and was supported by adequate consideration.

The erroneous decision of the Fourth Circuit presents important federal questions which should be considered and decided by the Court.

A. The Court Should Resolve the Conflict Between the Fourth Circuit's Restrictive Interpretation of "Transfer" Preventing a Bankruptcy Court from Setting Aside an Indirect Transfer and the Court's Prior Decisions Approving the Avoidance of Indirect Transfers.

The national debate over the avoidance of secondary or indirect transfers in bankruptcy began long ago. Under the former Bankruptcy Act of 1898, the Court noted that "circuity of arrangement" would not prevent the avoidance and recovery of property transferred by a bankrupt, the "effect of which is to enable one of his creditors to obtain a greater percentage of his debt than another creditor of the same class." National Bank of Newport v. National Herkimer County Bank, 225 U.S. 178, 184 (1912) (preference avoidance governed not by "mere form or method" of the challenged transfer, but by the disposition by an insolvent debtor of "property to the payment of a creditor's claim"); see also Dean v. Davis, 242 U.S. 438, 442 (1917) (the bank holding an unsecured claim that was paid by the proceeds of a secured loan made by a family member to the debtor was the true recipient of the avoidable preference, not the family member; "[h]ere [the family member] acted on the debtor's behalf in providing the money" used to pay the bank). The Fourth Circuit has similarly observed that "preferences obtained by indirect or circuitous arrangements are to be struck down just as quickly as those obtained by direct arrangements."

Aulick v. Largent, 295 F.2d 41, 52 (4th Cir. 1961) (preference avoided under Bankruptcy Act).[2]

More recently, the debate erupted again in the arena of preference avoidance, this time in the context of the liability of a non-insider creditor for payments benefiting an insider made within the insider preference period (1 year before bankruptcy filing), but beyond the non-insider preference period (90 days before bankruptcy filing). A defining case in this debate was Levit v. Ingersoll Rand Fin. Corp., 874 F.2d 1186 (7th Cir. 1989), in which the Seventh Circuit held that a transfer to a non-insider creditor that conferred a benefit on an insider was avoidable in an action against the non-insider, when the bankruptcy was filed within the insider preference avoidance period (1 year before bankruptcy filing), but beyond the non-insider preference avoidance period (90 days before bankruptcy filing). The Seventh Circuit in Levit discussing its rejection of the Bankruptcy

---

[2] In Aulick, the Fourth Circuit offered this explanation of its analysis of the transfer avoided as preferential in that case:

> *[i]f the bankrupt had delivered the shares of stock to Mrs. Aulick as security for the payment of her antecedent debt, she would have received a voidable preference* just as the transfer of stock to Lemley was a voidable preference. *She cannot do indirectly what she could not do directly* and destroy the protection provided by [the Bankruptcy Act preference section] for other creditors represented by the trustee in bankruptcy.

295 F.2d at 52 (emphasis supplied).

Although the Bankruptcy Court did not cite Aulick as authority, it made a similar finding in this case. App. 46-47.

Court's "two transfer" holding, explained its analysis as follows:

> [t]he two-transfer approach equates "transfer" with "benefit received." Both Lender and Guarantor gain from payment, and each receives a "transfer" to the extent of the gain. The [Bankruptcy] Code, however, equates "transfer" with payments made. Section 101(50) . . . says that a transfer is a disposition of property. Sections 547 and 550 both speak of a transfer being avoided; avoidability is an attribute of the transfer rather than of the creditor. While the lenders want to define transfer from the recipients' perspectives, the Code consistently defines it from the debtor's. A single payment therefore is one "transfer," no matter how many persons gain thereby.

874 F.2d at 1195-96.[3]

---

[3] There was no Circuit-level conflict with the Seventh Circuit's analysis in Levit. See, e.g., In re Meredith Hoffman Partners, 12 F.3d 1549, 1557-58 (10th Cir. 1994); In re Suffola, 2 F.3d 977, 981-82 (9th Cir. 1993); In re T.B. Westex Foods, Inc., 950 F.2d 1187, 1193-95 (5th Cir. 1992); In re H & S Transportation Company, Inc., 939 F.2d 355, 358-360 (6th Cir. 1991); In re C-L Cartage Co., Inc., 899 F.2d 1490, 1494-95 (6th Cir. 1990). However, the preference liability imposed on the non-insider creditor for these payments was widely perceived to be unfair and led ultimately to the amendment of Section 550(c) of the Bankruptcy Code in an effort to reverse or ameliorate the holding in Levit. See 11 U.S.C. § 550(c)(2000).

Even the Seventh Circuit in Levit recognized, however, that insiders remained liable for transfers from which they benefited and that a trustee could pursue either the benefited insider, the non-insider recipient of the payment, or both. 874 F.2d at 1194-97.[4]

The debate in this arena was largely silenced by the amendment of Bankruptcy Code Section 550(c) in a manner which precluded recovery of an avoided preference from a non-insider, where the transfer was made for the benefit of an insider, but the transfer occurred between 90 days and one year before the bankruptcy filing. See 11 U.S.C. § 550(c)(2000).

In this case, the debate surfaced again in the context of an action by the Trustee seeking to avoid transfers made by a debtor that resulted in the conferring of a benefit to the debtor and his non-bankrupt spouse without consideration, as a voluntary conveyance under applicable state law. Here, the Trustee sought to avoid the Pre-Payment as a voluntary conveyance, proceeding under Bankruptcy Code Section 544(b)(1), which allows the Trustee to avoid any transfer that might be challenged by a creditor under applicable law, here the law of the State of Virginia.

Although a debtor's making of regular, monthly, home mortgage payments prior to bankruptcy is not

---

[4] Overlaying this analysis on the present case, the Trustee could have sued Mr. & Mrs. Meyer (who benefited from the transfer in this case), the mortgage companies, or both. The Trustee chose to sue only Mr. & Mrs. Meyer, the parties who benefited from the transfer in this case.

remarkable, the size and result of the Pre-Payment in this case were unusual and suspect. These were not routine, monthly mortgage payments to a mortgage creditor; these were large lump-sum pre-payments of the entire balances of two mortgages on a financially distressed debtor's home, using funds which were indisputably the debtor's sole property. Moreover, the result of the Pre-Payment was even more striking: because the mortgages were pre-paid, and the Meyer Home was owned by Mr. & Mrs. Meyer as tenants by the entireties, Mr. Meyer claimed the entire value of the Meyer Home exempt from the bankruptcy estate when he filed individual bankruptcy, without his wife, pursuant to 11 U.S.C. § 522(b)(2)(B)(2000). Thus, the debtor's individual estate was depleted at the same time the debtor was securing the total release of all mortgages on the home owned jointly with his wife as tenants by the entireties, enabling it to be claimed exempt from the claims of his individual creditors when he later filed individual bankruptcy.

The Trustee asserted that by making the Pre-Payment, Mr. Meyer sought to accomplish indirectly what he could not accomplish directly. That is to say that if Mr. Meyer had taken the amount of the Pre-Payment and instead had purchased a new house with those funds, which he titled in the name of himself and his wife as tenants by the entireties, that transfer (to himself and his wife as tenants by the entireties) would have been avoided as a voluntary or fraudulent conveyance. In re Porter, 37 B.R. 56, 60 (Bankr. E.D.Va. 1984), citing In re White, 28 B.R. 240 (Bankr. E.D.Va. 1983). The Trustee argued that Mr. Meyer should not be permitted to effect the same result merely by pre-paying mortgages on his existing home, causing a release of equity to and conferring a

gratuitous benefit upon Mr. & Mrs. Meyer in their tenancy by the entirety, to the disadvantage of Mr. Meyer's individual creditors.

Two prior bankruptcy court decisions addressed similar fact situations, with different results. The Bankruptcy Court in In re Covino, 187 B.R. 773 (Bankr. S.D. Fla. 1995) held that a debtor's pre-payment of his home mortgage was an impermissible conversion of a non-exempt asset (cash settlement proceeds) into an exempt asset (equity in a home), avoided the transfer as a fraudulent conveyance and imposed an equitable lien against the home to secure repayment of the avoided transfer. The Bankruptcy Court in In re Theisen, 45 B.R. 122 (Bankr. D. Minn. 1984), found that a debtor's pre-payment of a seller's lien against his home was supported by fair consideration and denied the trustee's claim that the pre-payment was in fact a voluntary conveyance from the debtor into his "homestead," describing the trustee's challenge to the transfer as "strained." Id. at 127.

The Fourth Circuit's view of the present case was that the "transfer in this case, which is sought to be avoided, is the payment of Meyer to the mortgage holders." App. 10. That view reflects a fundamental misunderstanding by the Fourth Circuit of the Trustee's action as being directed at the mortgage companies. The Trustee did not challenge the Pre-Payment to the mortgage companies and those companies were not parties to the proceeding below. Instead, the Trustee sought to recover the value of the Pre-Payment from the parties who directly and gratuitously benefited from that Pre-Payment: Mr. & Mrs. Meyer. It was Mr. & Mrs. Meyer whose tenancy by the entirety swelled in value by the amount of the

Pre-Payment, all of which was claimed exempt from the claims of Mr. Meyer's individual creditors.

The Bankruptcy Court and the District Court correctly analyzed and properly applied the law applicable to avoiding indirect payments under these facts, consistent with the principles laid down in National Bank of Newport, supra, Dean v. Davis, supra and Aulick, supra. The decisions of the Bankruptcy Court and the District Court correctly prevented Mr. Meyer from accomplishing indirectly what the law would not permit him to accomplish directly. The decision of the Fourth Circuit below conflicts with these principles and should be reversed.

The Trustee submits that the resolution of these issues relating to the avoidance of indirect transfers by the bankruptcy court presents an important federal question relating to bankruptcy jurisprudence which should be decided by the Court.

B. The Court Should Resolve the Conflict Between the Fourth Circuit's Restrictive Interpretation of "Transfer" and the Court's Prior Decisions Outlining the Scope of the Bankruptcy Court's Equitable Powers and Provide Guidance to Lower Federal Courts in the Proper Exercise Of Those Powers.

The Fourth Circuit's decision also conflicts with decisions of the Court outlining the scope and application of the Bankruptcy Court's equitable powers.

Bankruptcy Courts are courts of equity. NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527 (1983); Katchen v. Landy, 382 U.S. 323, 327 (1966); Pepper v. Litton, 308 U.S. 295, 304 (1939). As such, the Bankruptcy Court's equitable powers are properly "invoked to the end that . . . substance will not give way to form [and] that technical considerations will not prevent substantial justice from being done." Pepper v. Litton, 308 U.S. at 304-5; In re A.H. Robins Company, Inc., 880 F.2d 694, 702 (4th Cir. 1989) (citing MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89, 94 (2d Cir. 1988)); Brockington v. Scott, 381 F.2d 792, 794 (4th Cir. 1967) ("recognition of substance over form" is "appropriate in bankruptcy proceedings" to avoid a "windfall" to one party at the expense of creditors).

In Pepper v. Litton, supra, the Court noted that "bankruptcy courts have exercised . . . equitable powers in passing on a wide range of problems arising out of the administration of bankrupt estates." 308 U.S. at 304-5. In Pepper, the Court considered and reversed a decision by the Fourth Circuit, and, among other things, held that the Bankruptcy Court's power to evaluate the validity of an insider's claim was not barred by the "mere fact" that the claim had been reduced to judgment in a state court. Id. at 305-7. Instead, the Court encouraged the Bankruptcy Court to "look behind the judgment to determine the essential nature of the liability for purposes of proof and allowance," and noted that "[i]n the exercise of its equitable jurisdiction, the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate." Id. at 307-8. Moreover, since Pepper involved stockholder self-dealing and a "planned and fraudulent scheme," the

Court observed that once the nature of the scheme was uncovered:

> it was the duty of the bankruptcy court in the exercise of its equity jurisdiction to undo it. Otherwise, the fiduciary duties of dominant or management stockholders would go for naught; exploitation would become a substitute for justice; and equity would be perverted as an instrument for approving what it was designed to thwart.

308 U.S. at 312.

In this case, the Trustee submits that once the Bankruptcy Court concluded that in substance the Pre-Payment was actually a transfer from Mr. Meyer to Mr. & Mrs. Meyer that was avoidable under Virginia law as a voluntary conveyance, the Bankruptcy Court was duty-bound to disregard the form of the transaction; to avoid the voluntary transfer; and to enter such orders consistent with its equitable analysis as would render substantial justice in the case.

In holding that the Pre-Payment was a transfer avoidable under the Virginia voluntary conveyance statute, the Trustee submits that the Bankruptcy Court correctly applied the equitable mandate of Bankruptcy Courts to look to substance, not form, guided by equitable principles articulated in Pepper, supra, Cramer, supra, Porter, supra, and White, supra and consistent with the decisions of the Virginia Supreme Court in Pacific Mutual, infra, and Stigler, infra. Applying these principles, the Bankruptcy

Court and the District Court concluded that the Pre-Payment was, in substance, a gift by Mr. Meyer of the Bequest to Mr. and Mrs. Meyer as tenants by the entireties, by the vehicle of pre-paying the home mortgages.

Nowhere in the Fourth Circuit decision was this conclusion questioned. Substantial justice requires that the decision of the Fourth Circuit be reversed. Otherwise, the effect of the Fourth Circuit decision is to materially impair, if not substantially undermine, the equitable powers of the Bankruptcy Court that are critical to the even-handed administration of bankruptcy jurisprudence.

Although the Fourth Circuit suggests that its decision is necessary to avoid disruption to transactions involving home mortgages, it did not consider the far-reaching effects of its analysis of the transfer to many other areas of bankruptcy and debtor-creditor law. By elevating the form of the transfer at issue in this case over its substance, the Fourth Circuit provided a cure that is far worse than any imaginable ills of the lower courts' judgments.[5]

---

[5] For example, the Fourth Circuit decision emphasizes that it is limited to the facts of this case involving an alleged voluntary conveyance sought to be avoided under Va. Code § 55-81 and did not address the issues presented by the Trustee's additional claim (not reached by the Bankruptcy Court) that the transaction was also a fraudulent conveyance challenged under Va. Code § 55-80. However, the existence of a "transfer" is required for either a voluntary or a fraudulent conveyance to have occurred. See Va. Code §§ 55-80, 55-81. The Fourth Circuit's decision flatly rejects the "second transfer theory" alleged by the Trustee that "the payment of the mortgages was itself a second transfer because the land was held by the entireties." App. 10-11.

The potential for mischief presented by the decision of the Fourth Circuit can readily be seen when one considers whether it will now ever be possible in the Fourth Circuit for a bankruptcy trustee to avoid any type of payment of a secured debt, where the collateral is owned by the entireties, even if the payment is made with the express purpose to hinder, delay or defraud creditors. This is because the Fourth Circuit holds that when the debtor makes a mortgage payment there is only one transfer (to the mortgage company) and the resulting increase in equity in the collateral entireties property is not a transfer.[6]

The Fourth Circuit's decision in this case elevates form over substance, ignores the equitable findings and analysis of the Bankruptcy Court and the District Court, and effectively insulates all pre-payments of secured debt on entireties property, even where the size, circumstances or the express or implied intent of the transferor demonstrate that the

---

[6] The manner of ownership of the collateral property is significant here. If the collateral property is owned individually by the debtor who makes the payment, then the reduction of the secured creditor's lien against the property operates as a return of equivalent value to the debtor's estate. Thus, the creditors of the individual debtor are not harmed by the transfer. However, where the collateral is held jointly with a spouse in a tenancy by the entireties, then when the secured creditor's loan is reduced (or, as here, satisfied), the equity which is created inures not to the debtor making the payment, but to the debtor and his spouse as tenants by the entireties. Thus, in this case, where one co-debtor makes a large pre-payment and converts an individual asset into an entireties asset, that co-debtor's individual creditors are deprived of what they would have been entitled to prior to the payment and the transfer becomes insulated in the hands of the tenants by the entireties. Such an outcome is manifestly unjust to the creditors of the spouse who makes the transfer, however attractive it may be as an insolvency planning device.

pre-payment was fraudulent or lacked any consideration deemed valuable in law. This result is inconsistent with Pepper v. Litton, supra, in which the Court directed that "substance will not give way to form [and], that technical considerations will not prevent substantial justice from being done." 308 U.S. at 305.

This case presents the Court with a significant opportunity to resolve a conflict between the Court's prior holdings relating to the Bankruptcy Court's equity powers and the Fourth Circuit's decision in this case and to provide suitable guidance to lower federal courts in the proper exercise of those powers.

C. The Court Should Resolve the Conflict Between the Fourth Circuit's Restrictive and Formalistic Interpretation of "Transfer" and the Virginia Supreme Court's Decisions in Pacific Mutual and Stigler, Where Substance Prevailed over the Form of the Transaction Subject to Avoidance.

Finally, the Fourth Circuit's decision also conflicts with two well-established decisions from the Supreme Court of Virginia. White v. Pacific Mut. Life Ins. Co., 150 Va. 849, 143 S.E. 340 (1928); Stigler v. Stigler, 77 Va. 163 (1883).

White v. Pacific Mut. Life Ins. Co., 150 Va. 849, 143 S.E. 340 (1928), and Stigler v. Stigler, 77 Va. 163 (1883) both involved insurance policies and claims by creditors of a decedent against the proceeds of the policies which were in the hands of or destined for the decedent's surviving spouse. In each case, the

Virginia Supreme Court held that a decedent's payment of premiums, while insolvent, on policies of insurance which benefited a surviving spouse was a voluntary conveyance and would be avoided, up to the amount of the premium payment. 150 Va. at 862; 77 Va. at 168-69. Avoidance was required, despite the fact that there was clear and undisputed "consideration" which flowed from the primary transferee (the insurance company) to the debtor to support the payment. In both Pacific Mutual and Stigler, the Virginia Supreme Court held that creditors were entitled to recover the amount of the premium payments out of the proceeds of the policy received by or for the benefit of the decedent's spouse as voluntary conveyances. Id.

In Pacific Mutual, the Supreme Court of Virginia quoted from Lile's Notes on Equity Jurisprudence, where it was said that:

> [t]he payment of such premiums, while insolvent, is manifestly a *voluntary transfer of property without providing for existing debts* – and seems clearly within the terms of the [voluntary conveyance] statute. We have already seen that if the insolvent settles *houses and lands,* or *money,* or *securities,* directly upon his wife, when not bound thereto by antenuptial contract, equity will let in existing creditors upon the property. No difference is perceived where he settles an *insurance policy* upon her, and devotes money which should go to his creditors to the payment of premiums on the policy.

> **"In Virginia it is settled that under our statute of voluntary conveyances, premiums thus paid on a policy of insurance for the benefit of another, are within the purview of the statute; and that existing creditors of the insured may subject the proceeds of the policy after death of the insured,** *to the extent of the premiums so diverted* **and within the period permitted by the statute of limitations (five years in Virginia, in the case of a purely voluntary conveyance)."**

150 Va. at 862 (italics in original; emphasis added).

Lile cited Stigler v. Stigler, supra, in support of his statement of Virginia law, which the Virginia Supreme Court discussed in Pacific Mutual:

> In [Stigler] each of the policies was intended as a gift to accrue to the beneficiaries therein named. When the premiums on them were paid, the insured was indebted. The obvious intent of the statute is to invalidate as against existing claims of creditors every gift or voluntary assignment of the debtor's property, **without regard to its object or the form in which it is made.** It is plain therefore, that to the extent the means of the insured were withdrawn from creditors and applied to the payment of premiums on the policies in question, the payments were void as

> against creditors, and that they were entitled to have the sums so paid applied to the discharge of their claims, out of the proceeds of the policies. . . **because when [the decedent] paid the premiums, he was using his creditors' money; money which they had the right to demand should be paid on their debts.**

Id. at 862-63 (emphasis added).

The holdings of the Virginia Supreme Court in Pacific Mutual and Stigler, plainly show that: (1) Virginia's voluntary conveyance statute requires analysis of the secondary, or indirect, effects of a debtor's transfer of assets to third parties; (2) under Virginia's voluntary conveyance statute, the secondary or indirect transfer can be avoided and assets can be recovered from the proceeds of that transfer, even where the primary or initial transfer was amply supported by "consideration deemed adequate in law," and (3) the modest amount, routine nature, or societal benefit of underlying transfers do not warrant an exception of the challenged transaction from the application of Virginia's voluntary conveyance statute.

Applied to the facts of this case, the Trustee submits that Pacific Mutual and Stigler demonstrate that the Fourth Circuit clearly erred in (a) focusing exclusively on the primary transfer to the mortgage companies, (b) holding that Virginia's voluntary conveyance statute did not apply to the indirect transfer of the Pre-Payment (a non-exempt asset) into equity in the entireties real estate (an exempt asset) which the Trustee sought to avoid in this case, and (c) analyzing the adequacy of consideration merely at the

level of the first or superficial transfer, and not (from the perspective of the creditors of Mr. Meyer) as against the secondary or indirect transfer.

The Court has considered important federal questions presented within bankruptcy cases, even where those issues involved the application of state law to a particular issue arising in a bankruptcy case. See Raleigh v. Illinois Dept. of Revenue, 530 U.S. 15 (2000) (Illinois use tax); Fidelity Financial Services, Inc. v. Fink, 522 U.S. 211 (1998) (perfection of motor vehicle security interest under Missouri law); Citizens Bank of Maryland v. Strumpf, 516 U.S. 16 (1995)(right of setoff under Maryland law); BFP v. Resolution Trust Corporation, 511 U.S. 531 (1994)(state foreclosure law); Barnhill v. Johnson, 503 U.S. 393 (1992)(New Mexico Commercial Code-Article 3).

The Trustee submits that this case presents a proper and important federal question arising in the context of the Fourth Circuit's failure to properly apply the law of Virginia to the facts of this case.

X. CONCLUSION

For the foregoing reasons, the Trustee respectfully requests that the Court issue a writ of certiorari to the United States Court of Appeals for the Fourth Circuit in this case.

HARRY SHAIA, JR., TRUSTEE

/s/ James J. Burns

By _____
Counsel

James J. Burns, *Counsel of Record*
Patrick R. Hanes
WILLIAMS, MULLEN, CLARK & DOBBINS, P.C.
P.O. Box 1320
1021 E. Cary Street
Richmond, Virginia 23218-1320
(804) 643-1991

July 23, 2001